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Joint Testimony of the National Association of Health and Educational Facilities Finance Authorities Regarding the March 19, 2013 Hearing on “Tax Reform and Tax Provisions Affecting State and Local Governments.”

The National Association of Health and Educational Facilities Finance Authorities (NAHEFFA), respectfully submit this testimony relating to the Committee's hearing on municipal finance and tax reform. We represent the major issuers of nonprofit, 501(c)(3) tax-exempt bonds. Our purpose is to describe the vital role this financing plays in providing critical public services and enhancing and maintaining the economic strength of countless communities across the United States.

NAHEFFA (www.naheffa.com) represents 43 issuers of nonprofit tax and bonds in 35 states. Most of its members are statewide issuers with decades of experience and expertise in assisting large and small nonprofit institutions accessing the capital markets. While some authorities issue only for health or education institutions, a number of authorities issue for multiple purposes and also include youth activities, the arts, and museums. These financings support hospitals, health clinics, drug and alcohol treatment centers, boys and girls clubs, small and large colleges and universities, and other purposes and compose the majority of so-called “private activity bonds.”

Tax exempt financing was authorized for federally recognized 501(c)(3) organizations in the Revenue and Expenditure Control Act of 1968. The authorization was consistent with the principles that have governed federal tax since the early 19th century by recognizing the legal appropriateness of government support for charitable organizations.

Although technically these financings are classified private activity bonds because the use and repayment of the bonds is by “nongovernmental” persons, nonprofits which benefit from tax-exempt financing are entities recognized for their public purpose under state and federal laws. Further, tax exempt bond financings may only occur through authorities and other issuers specifically created or authorized under state laws which impose additional criteria and procedures to ensure the public purpose and benefits of these financings.

Many of the institutions benefiting from tax exempt bond financings are an integral part of the social "safety net" created and supported by governments. In fact, many of the non-profits benefitting from tax exempt bonds provide a safety net for those who fall between the cracks of state and local government services. Thousands of hospitals and other healthcare providers, colleges and universities and other nonprofit educational organizations serve as a tangible part of the very fabric of their local communities through their services and their economic stability, employment and stimulus of other goods and services.

Any analysis that concludes that a disproportionate percentage of the benefits of tax exempt financing is enjoyed only by wealthy individuals is mistaken, as other commenters have noted in submitted testimony. These analyses, frequently totally neglect the real world advantages and efficiencies of this decentralized system of decision-making and allocation of capital. Through their statutory authorization, boards, state and local oversight and the transparency required by public disclosure laws, these financings reflect the best federalist policies of local control and decision making by those in the best position to make educational and health care facility decisions in an environment of scarce financial resources. The system effectively sorts projects through determinations not only by the issuing authorities, but by the borrowers who must show to investors feasibility of repayment. To paraphrase Professor John Buckley's testimony, this is a conservative method of providing federal support for state and local investment in public purpose, non-profit facilities, minimizing the role of federal government, limiting the possibility of earmarks, and placing the decisions for public purpose investments in the hands of issuers and borrowers who have every incentive to be financially responsible.

In contrast, direct federal financial support working independently of the capital markets tends to be an ineffective substitute. Approval and implementation of projects tends to be slow, poorly targeted and highly subject to political pressures. By contrast, the capital markets – albeit with the federal subsidy – have important advantages as providers of timely, low – cost capital for projects selected by borrowers and approved by issuers. These parties have strong incentives to use proceeds efficiently to minimize annual debt service and maintain credit ratings. This approach often leverages direct federal support for health and higher education by recognizing, particularly in the aftermath of the recession and serial federal budget crises, that there is not, nor likely to be, sufficient federal capacity to pay for the needed improvements and infrastructure of the nonprofit and governmental sectors. The genius of the current federal –state/local-non- profit partnerships which constitutes tax-exempt financing for 501(c)(3) institutions is that it recognizes the limits of direct federal funding and provides for a viable alternative.

It is also critical to appreciate that these financings, and the borrowing institutions, are heavily regulated under state and federal law. For example, the Internal Revenue Code imposes strict arbitrage, advanced refunding, cost of issuance and other requirements. Further, these institutions are increasingly called upon by the marketplace and by federal and state regulations to provide large amounts of information informing investors and the public about their operations, including the use of the bond proceeds. That 501(c)(3) financings are not subject to the state-by-state private activity bonds reflects, as JCT indicated, the well-founded belief that tax-exempt bonds for nonprofit have a larger component of benefit to the general public than do many other private activities eligible for the tax exemption.

Beyond the well-recognized and critical public services that education and healthcare offer in every community across the United States, these institutions, large and small, often are among the most significant employers in their communities whether urban, suburban or rural. Their well-being and the financing of improvements and new infrastructure in buildings and equipment provide major employment multiplier effects directly and indirectly.

A variety of proposals have been made to restrict or dilute the benefits of tax exempt financing in general and for nonprofit bonds in particular. While well-intentioned, these

proposals are problematic and damaging to the public interest. The most extreme proposal would simply be to eliminate the tax exemption for 501(c)(3) financing and require thousands of health and education institutions across the country to access capital only through the taxable market. No one denies that this would have a significant and negative impact on borrowing costs, particularly for the thousands of small health care and education institutions with low or no credit rating. Borrowing costs could increase by as much as two percent and in many cases projects would be delayed, postponed, canceled or never developed. This approach not only would undermine the critical missions of the schools and hospitals but increase education and healthcare costs.

More empathetic proposals are aimed at developing or expanding types of direct pay bonds. First, there has been a continuing attempt to impose on the marketplace tax credit bonds. This is an alternative that simply won't work well and has not where it is available due to the lack of "stripability" of the tax credits. It is not an attractive investment, particularly for those not seeking such credits.

Somewhat more useful but still seriously flawed options as total substitutes for tax exempt bonds are direct pay bonds similar to the popular Build America Bonds and the infrastructure bonds President Obama has proposed. BAB's were not available to nonprofits, and if they are revived in some form there are highly credit worthy nonprofits that would benefit from the opportunity to use them. Direct pay bonds also have the secondary benefit of improving the overall tax exempt bond market because of the impact on supply. But, if, as is likely, any renewed BAB program will set subsidies at significantly lower interest rates than the previous program it is unlikely these bonds would be viable.

In addition, the credibility of the federal government as a partner in this type of program is under serious question. Not only were the initial BAB's allowed to lapse but all proposals to renew them have been at significantly different terms. There is no reason to think that this approach would not continue in the future, meaning that nonprofits, just like state local governments, cannot rely on them for their future basic financing needs. In addition, through the application of offsets and now reductions in payments due to sequestration the viability of this

approach is suspect. There is simply no assurance for nonprofits that the level of subsidy and continuity of payments are reliable. Finally, there is great reason to doubt that many of the purchasers of these types of bonds, such as non-US tax payers, would have much interest in the thousands of small colleges and clinics that presently benefit from tax-exempt financing. The cost of marketing and placing BAB's around the world would be infeasible for the vast majority of 501(c)(3) borrowers.

There also have been proposals to limit the benefits of tax-exempt interest to high income individuals. Unfortunately, the main impact of these proposals, particularly as they are applied retroactively, is to greatly devalue tax-exempt debt, thereby imposing severe penalties on health and education institutions across the United States.

The proposed 28% cap on deductions and exemptions would effectively impose a tax on otherwise tax exempt interest. The practical and direct consequence of this action would be not only to disincentivize potential investors but also to require them to seek a higher return for tax exempt bonds. An additional grave concern about this proposal is that it would apply to interest in existing bonds, representing a violation of the basic assumption that Congress will not change the terms governing the taxability of interest for bonds already outstanding. In the nearly hundred year history of the tax exemption, Congress has never applied a retroactive tax to bonds already held by investors. It is estimated that borrowing rates could increase between 60 to 75 basis points if this proposal is enacted.

Alternatively there is a proposal for a dollar threshold cap on deductions and exemptions (e.g., \$50,000). This proposal would limit the total amount that taxpayers from all income brackets may use for federal income tax purposes. Its consequence could well be that there would be no benefit for many investors to purchase municipal securities since they will apply to the cap and prioritize the use of essentially "nonvoluntary" deductions such as the home mortgage and state local tax deduction. Because this proposal would affect all taxpayers, it is estimated that nonprofit and state and local borrowing costs could rise between 120 – 250 basis points.

We urge the Committee in its deliberations of Tax Reform to maintain the current law exemption from income of tax-exempt bonds. We urge the Committee not to eviscerate an imperfect but critical method for thousands of charities and health and education nonprofits across the country to access vitally needed capital. We also urge the Committee not to make decisions that paint with broad strokes what constitutes private activity bonds but to consider carefully the public purpose services critical to our communities provided by nonprofit health and education institutions that are supported by the tax exemption for 501(c)(3) nonprofit bonds. It is critical to maintain the access to affordable capital that results from the current partnership between issuing authorities and hospital and education borrowers.

Respectfully submitted,

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